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In the Supreme Court of the United States

OCTOBER TERM, 1939

No. 417

NEW WORLD LIFE INSURANCE COMPANY, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the court below (R. 32–60) is reported in 26 F. Supp. 444.

JURISDICTION

The judgment of the court below was entered on March 6, 1939 (R. 60). A motion for a new trial was overruled on May 29, 1939 (R. 60). The petition for a writ of certiorari was filed on September 25, 1939, the time for filing having been extended by order of this Court (R. 70). The jurisdiction of this Court is invoked under Section 3 (b) of the

Act of February 13, 1925, as amended by the Act of May 22, 1939.

QUESTIONS PRESENTED

1. Whether, under Section 203 (a) (5) of the Revenue Acts of 1928 and 1932, a life insurance company may, for federal income tax purposes, allocate to and deduct as investment expenses, without limitation, a portion of the salaries paid to its officers for services performed generally in all departments of its business.

2. Whether, under Section 203 (a) (2) of the Revenue Acts of 1928 and 1932, a life insurance company is entitled, for federal income tax purposes, to a deduction on account of reserve funds held by it to cover liability under outstanding policies of health and accident insurance.

STATUTES INVOLVED

The pertinent portions of the applicable statutes are set out in the Appendix.

STATEMENT

The special findings of fact of the court below (R. 17–32) may be summarized as follows:

Petitioner is a stock life insurance company, organized under the laws of the State of Washington, with its principal offices in Seattle (R. 17). During the years 1929 to 1932, inclusive, and prior thereto, petitioner was engaged in the business of issuing and selling life insurance in Washington and other states (R. 17).

In its tax returns for those years petitioner deducted from gross income as investment expenses certain percentages of the salaries which it paid to its president, treasurer, general counsel, and cashiers, the total amounts of such deductions being as follows: For 1929, $17,149.92; for 1930, $21,492.21; for 1931, $24,124.61; and for 1932, $26,634.31 (R. 18–22). The portions of the salaries thus deducted were charged by petitioner to its investment expenses, pursuant to a resolution adopted by its board of directors in 1929 (R. 24–25). The salaries of these officers and cashiers were for all services rendered by them, and their services related to matters in all departments of petitioner's business, *i. e.*, in both the investment and underwriting departments (R. 24).

In his final determination of petitioner's tax liability, the Commissioner of Internal Revenue allowed deductions for expenses incurred directly in the investment department, as follows: For 1929, $38,730.29; for 1930, $41,197.85; for 1931, $40,818.53; and for 1932, $36,867.70; and disallowed the aforementioned portions of the salaries of petitioner's general officers which it had assigned to investment expenses (R. 18–22). One-fourth of one per centum of the mean of petitioner's invested assets for these years is as follows: For 1929, $21,465.27; for 1930, $23,243.10; for 1931, $24,513.65; and for 1932, $24,872.81 (R. 19–23).

Some of petitioner's life insurance policies, all of which are on the level premium plan, contained

additional provisions for health and accident insurance (R. 17). The average mean of the reserve funds held by petitioner during the years involved herein for the fulfillment of its life insurance contracts was approximately $7,500,000, and for fulfillment of its health and accident policies was approximately $195,000 (R. 17–18).

Petitioner issues health and accident insurance only in a combined policy of life, health, and accident insurance, *i. e.*, by the insertion of an additional sheet (R. 66) covering health and accident insurance in a standard form of life policy (R. 26). A separate premium is charged for the health and accident insurance, which may be discontinued without affecting the life insurance (R. 26). The reserves held on account of health and accident insurance do not enter into the amount of the reserves held on account of life insurance covered by the policy, nor do they enter into the surrender, cash, or loan values of the policies (R. 26, 61–68).

In its tax returns petitioner took deductions on account of reserves held by it to meet liabilities arising under policies of health and accident insurance (R. 18–23). In his final determination the Commissioner treated these deductions as follows: For 1929 and 1930 he allowed deductions as taken by petitioner. (The Government thinks these deductions were erroneous, but any recovery is now barred.) For 1931 and 1932 he disallowed deductions in respect to reserves held on account of dis-

abled lives, and allowed deductions on account of active lives (R. 18–23).

Timely claims for refund were filed by petitioner for all the claims and years involved, and were rejected by the Commissioner (R. 30–32).

The court below held that the petitioner was not entitled to recover and dismissed the petition (R. 60).

ARGUMENT

I

Section 203 (a) (5) of the Revenue Acts of 1928 and 1932 provides that life-insurance companies may deduct—

> Investment expenses paid during the taxable year: *Provided,* That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year. * * *

Petitioner charged to its investment expenses portions of the salaries which it paid to its president, treasurer, general counsel, and cashiers, all of whom were employed generally in all departments of its business. It claims the right to deduct such amounts as "investment expenses," and not as "general expenses * * * in part assigned to or included in the investment expenses." It has been allowed deductions for direct investment ex-

penses in excess of the one-fourth of 1 per centum limitation provided by the statute where general expenses are in part assigned to investment expenses. The Commissioner of Internal Revenue rejected petitioner's claims for deductions on account of the allocated portions of the salaries,[1] and the court below upheld his determination.

The decision below is plainly correct. The term "general expenses" clearly was used in contradistinction to expenses incurred directly in the investment department, and salaries of the general officers are certainly general expenses. Petitioner's contention leads to the conclusion that whenever a general expense is assigned in part to investment expenses it thereupon becomes a direct investment expense. Since direct investment expenses are deductible without limitation, the conclusion renders meaningless the limitation provision of the statute.

The interpretation given the provision below is supported by the general scheme of the Revenue Acts for the taxation of life-insurance companies, and by the reason for the particular provision in question. Only the investment income of life-insurance companies is taxed, and not their income from premiums. Accordingly, deduc-

[1] Instead of allowing petitioner's claims and then invoking the one-fourth of 1 per centum limitation because general expenses were in part assigned to investment expenses, the Commissioner followed the more liberal course of disallowing the claims entirely. Petitioner was thereby given the benefit of allowance in full of the undisputed investment expenses.

tion is allowed only of investment expenses. And since, by general practice, premiums are so adjusted as to cover general operating expenses, general expenses are not allowed to be deducted except as assigned to investment expenses, and then only to bring the deduction for such expenses up to the statutory maximum. (See R. 35–45.)

The decision below overrules the earlier decision of the court below in *Sun Life Ins. Co.* v. *United States*, 81 C. Cls. 892, and is in conflict with the decisions of the Board of Tax Appeals in *Volunteer State Life Ins. Co.* v. *Commissioner*, 27 B. T. A. 1149, 35 B. T. A. 491, now pending on appeal in the Circuit Court of Appeals for the Sixth Circuit. In those decisions the considerations just discussed were not considered, and the court accordingly refused to follow them (R. 45). The present decision is not contended to be and is not in conflict with any decision of any federal court of appeals.

II

Section 203 (a) (2) of the Revenue Acts of 1928 and 1932 (*infra*, pp. 11–12) provides that a life insurance company may deduct an amount equal to 4 per cent of the mean of the reserve funds required by law and held at the beginning and end of the taxable year. Petitioner contends that under this provision it is entitled to deductions on account of reserve funds held by it to cover health and accident insurance, and not merely to deductions on account of reserves held to cover life insurance.

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The decision below to the contrary follows the decisions of this Court in *Helvering* v. *Illinois Ins. Co.*, 299 U. S. 88, and *Helvering* v. *Inter-Mountain Insurance Co.*, 294 U. S. 686. In the former case the Court held that Section 203 (a) (2) did not permit deductions on account of reserves held to cover payments under a "survivorship investment" feature of 20-payment life policies. It said (299 U. S. at 90):

> The phrase "required by law" includes only reserves that directly pertain to life insurance. Other reserves, even though required by state statutes regulatory of the business authorized to be carried on by life insurance companies, are not included. * * *

See also *New York Life Ins. Co.* v. *Edwards*, 271 U. S. 109, 119; *United States* v. *Boston Insurance Co.*, 269 U. S. 197. The reserves for health and accident insurance on account of which petitioner claims deductions are not only not held on account of life insurance, but are not of the same character as technical life insurance reserves.[2]

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[2] They are required by the laws of Washington (*infra*, p. 16) to be computed upon the net premium basis, and the mortality element is incidental and does not involve the element of life risk as in the case of life insurance. In a life policy the mortality element requires the building up of a reserve sufficient to meet the policy obligations at maturity, that is, at death, while in health and accident insurance death, instead of maturing the liability, terminates the risk. Moreover, in health and accident insurance the contingency for which reserves are held may never happen.

Petitioner points out (pp. 19–20) that the Treasury Regulations prior to T. D. 4615, XIV–2 Cum. Bull. 310 (1935), allowed reserve deductions of the character involved in this case, and contends that the decision below, in refusing to follow the pre-1935 Regulations, is in conflict with *Helvering* v. *Reynolds Co.*, 306 U. S. 110. That decision did not purport to overrule or modify any of the principles established by this Court on the force and effect of Treasury Regulations. The court below was correct in stating (R. 59) that the earlier Regulations were not in harmony with the decisions of this Court, and it is well settled that changes in the Regulations are authorized in such a situation. See *Manhattan Co.* v. *Commissioner*, 297 U. S. 129, 134–135; *Morrissey* v. *Commissioner*, 296 U. S. 344, 355. Reenactment of a statutory provision does not validate an otherwise invalid regulation. *Koshland* v. *Helvering*, 298 U. S. 441, 446–447; *Biddle* v. *Commissioner*, 302 U. S. 573, 582. Petitioner also points out (p. 28) that the decision below is in conflict with certain decisions of the Board of Tax Appeals,[3] but does not contend that it is in conflict with any decision of any court.

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[3] *Equitable Life Assurance Society* v. *Commissioner*, 33 B. T. A. 708; *Monarch Life Ins. Co.* v. *Commissioner*, 38 B. T. A. 716, now pending in the Circuit Court of Appeals for the First Circuit; *Pan-American Life Ins. Co.* v. *Commissioner*, 38 B. T. A. 1430, now pending in the Fifth Circuit; *Oregon Mutual Life Ins. Co.* v. *Commissioner* (memorandum opinion, rendered January 4, 1939), now pending in the Ninth Circuit.

CONCLUSION

The decision below follows the decisions of this Court and is not in conflict with any decision of any circuit court of appeals. The questions involved are of no more general importance than most tax questions, which necessarily affect a large class of taxpayers. It is therefore respectfully submitted that the petition should be denied.

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NOVEMBER 1939.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 201. TAX ON LIFE INSURANCE COMPANIES.

(*a*) *Definition.*—When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

* * * * *

SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(*a*) *General rule.*—In the case of a life insurance company the term "net income" means the gross income less—

(1) TAX-FREE INTEREST.—The amount of interest received during the taxable year which under section 22 (b) is exempt from taxation under this title;

(2) RESERVE FUNDS.—An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subsection, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life

and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

* * * * *

(5) INVESTMENT EXPENSES.—Investment expenses paid during the taxable year: *Provided*, That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year; * * *.

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 203. NET INCOME OF LIFE-INSURANCE COMPANIES.

(a) GENERAL RULE.—In the case of a life-insurance company, the term "net income" means the gross income less—

* * * * *

(2) RESERVE FUNDS.—An amount equal to 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum. Life-insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, shall be allowed, in addition to the above, a deduction of 3¾ per centum of the mean of such reserve funds

(not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

* * * * *

Washington General Statutes (Pierce's Code, 1929, Vol. 1):

SEC. 2990. *Insurance Classified.*—Sec. 83. All business in this state is hereby classified as follows:

(1) Fire and marine insurance, upon buildings and other property against loss or damage by fire, lightning, wind storms, cyclones, tornadoes, hail, or earthquakes, water from the breakage or leakage of sprinklers, pumps, or other apparatus erected for extinguishing fires, and water pipes; and against accidental injury to such sprinklers, pumps, or other apparatus; and against loss or damage arising from the prevention or suspension of rent or use and occupation of any building, plant or manufacturing establishment due to the hazard or peril insured against; and upon vessels, boats, cargoes, goods, merchandise, freight and other property against loss or damage by the risks of lake, river, canal and inland transportation and navigation, including insurance upon automobiles, whether stationary or being operated under their own power, and reinsurance of any risks taken in this class; but not upon ocean marine risks, and other casualty insurance risks.

(2) Marine insurance, being ocean and inland risks, transportation and automobiles, but not including any other casualty insurance as hereinafter provided.

(3) Life insurance, being [including] endowments and annuities, but not including health, or accident or sickness insurance or any other casualty insurance as hereinafter provided.

(4) Accident insurance, and either sickness or health insurance being insurance against injury, disablement, or death resulting from travel or general accident, and against disablement resulting from sickness; and every insurance appertaining thereto.

* * * * *

(6) Liability insurance, being all insurance against loss or damage resulting from accident to or injury, fatal or non-fatal, suffered by an employe or other person and for which the insurer is liable.

SEC. 2991. *Insurance Permitted.*—Sec. 84. Any insurance company having the required amount of capital, or assets, when permitted by its articles of incorporation or charter, may be authorized and licensed by the commissioner to make insurance in this state under one or more of the classes prescribed in the several paragraphs in section 83 of this act, as follows:

* * * * *

Life. (3) No stock company shall make insurance in this state under class three of section 83 without having a capital stock fully paid of at least one hundred thousand dollars ($100,000.00) with a surplus of not less than fifty thousand dollars ($50,000.00), nor shall such company make insurance in this state in any other of said classes of insurance except in classes four and six; nor to make insurance in class four without having additional capital of at least fifty thousand dollars ($50,000.00); nor to make

insurance in class six without having additional capital of at least two hundred thousand dollars ($200,000.00) nor to make insurance in classes four and six without having additional capital of at least two hundred and fifty thousand dollars ($250,000.00).

SEC. 2999. *Life—Legal Reserve.*—Sec. 92. The commissioner shall annually make valuation of all outstanding policies, additions thereto, unpaid dividends, and all other obligations of every life insurance company doing business in this state; and all such valuations made by him or his authority shall be according to the standard of valuation adopted by the company: *Provided,* That in either case the standard of valuation employed shall be stated in his annual report: *Provided further,* That no such standard of valuation whether on the net level premium, preliminary term, or select and ultimate reserve basis, for policies issued after the passage of this act shall be less than that determined upon such basis according to the American Experience Table of Mortality with three and one-half per centum interest. The commissioner may vary the standard of valuation in particular cases of invalid lives and other extra hazards: *Provided,* The same is on basis of at least three and one-half per centum, value policies in groups, use approximate average for fractions of a year, and assume as accurate the valuation of the department of insurance of any other state or country, if the insurance officer of such other state or country likewise accredits the valuation made by the commissioner of this state: *Provided,* That when the preliminary term basis is used it shall not exceed one year.

The legal minimum standard for the valuation of annuities issued after January first, nineteen hundred and twelve, shall be "McClintock's Table of Mortality Among Annuitants," or the American Experience Table of Mortality, with interest at three and one-half per centum per annum, but annuities deferred ten or more years and written in connection with life or term insurance shall be valued in the same mortality table from which the consideration or premiums were computed, with interest not higher than three and one-half per centum per annum.

* * * * *

SEC. 3001. *Health—Reserve.*—Sec. 94. The commissioner shall annually make valuations of all outstanding policies of every company insuring against disablement by sickness, on the net premium basis, according to the "British Friendly Society Tables, eighteen hundred and eighty," or the "Manchester Unity Friendly Society Tables," eighteen hundred and ninety-three to eighteen hundred and ninety-seven, with interest at three and one-half per centum per annum. He may, in his discretion, vary the standard in particular cases, and may also require additional reserve because of hazardous occupations, impairment of the lives of the insured or insufficient net premiums. This provision shall not apply to policies insuring for not longer than one year without privileges of renewal.

U. S. GOVERNMENT PRINTING OFFICE: 1939